Decision 04-01-027 January 8, 2004

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Sierra Pacific Power Company (U 903 E) for an Order Authorizing an Immediate Interim Rate Increase, subject to Refund and for Consideration of a Rate Stabilization Plan.	Application 01-06-041 (Filed June 29, 2001; Phase 2 filed April 1, 2002)

David M. Norris, Attorney at Law, for applicant.
James E. Scarff, Attorney at Law, for Office of Ratepayer Advocates.
Andrew J. Skaff, Attorney at Law, for California Ski Areas Association.

OPINION GRANTING A RATE INCREASE OF $3.02 MILLION

A. Summary

This decision grants a rate increase of $3.02 million based on a settlement agreement of the parties. It finds that the New Customer Only method is appropriate to determine marginal customer costs. It increases rate by 8.8% to all customer classes except large commercial, which get no increase because their marginal costs are significantly below their current revenue allocation.

B. Background

In June 2001, Sierra Pacific Power Company (Sierra) sought a $10.2 million, interim 2-cent-per-kWh rate increase for all of Sierra's retail customers in California, based on a projected negative rate of return of 3.42% (Phase 1). Sierra requested that the interim rate increase be implemented subject to refund, pending a final decision on Sierra's Rate Stabilization Plan. In its filing Sierra asserted that it was preparing a detailed Rate Stabilization Plan to be filed in April 2002 (Phase 2), to include a complete general rate case (GRC), a proposal to reinstitute the energy cost adjustment clause (ECAC), a proposal pertaining to the termination of the 10% rate reduction mandated by Assembly Bill (AB) 1890 (Stats. 1996, Ch. 854), disposition of the Transition Cost Balancing Account (TCBA) and implementation cost recovery, a proposal to reinstitute the California Alternative Rates for Energy (CARE) balancing account in 2002, and a modification of the distribution performance ratemaking mechanism (PBR).

On July 17, 2002, in Phase 1, the Commission issued Decision (D.) 02-07-031 which granted Sierra's request for an interim rate increase of $10.2 million ($0.02/kWh) applied to all customer classes except those eligible for CARE and medical baseline, subject to refund.

Sierra filed Phase 2 on April 1, 2002 seeking a GRC increase that would raise its authorized revenue requirement by $8.9 million or 17.1% based on test year 2003. On December 18, 2002, Sierra filed an amendment to its Phase 2 application that reflected the impact of D.02-07-031 and agreements with Office of Ratepayer Advocates (ORA) on various issues. The effect of the amended application was a lowering of Sierra's requested revenue requirement increase to $4.8 million or 9.2%. ORA filed it report on Sierra's test year 2003 application recommending an increase of approximately $1.6 million or 3.3%. The California Ski Areas Association (CSAA) protested the proposed rate allocation.

Sierra, headquartered in Reno, Nevada, provides retail electric service to approximately 310,000 customers, of whom 44,500 are located in eastern California. All of Sierra's remaining customers are in northern Nevada. Sierra's

California service territory extends from Portola in the north to Markleeville in the south, with most customers located in and around the Lake Tahoe Basin. Sierra's northern Nevada control area includes its California service territory and is not under the operational control of the California Independent System Operator (ISO). Virtually all of Sierra's generation assets are located in northern Nevada and none of those assets have been sold.

Public hearing was held and the matter was submitted. At the conclusion of the hearing, the presiding Administrative Law Judge (ALJ) directed the parties to submit a result of operations table on April 30, 2003. During the preparation of this exhibit, the parties commenced settlement discussions which resulted in an agreement that Sierra's revenue requirement should be increased to $3.02 million or 5.8%. A settlement agreement explaining how the parties arrived at this amount was filed on June 6, 2003. Because of the settlement agreement, no issues pertaining to Sierra's revenue requirement remain in contention. The parties continue to disagree on the methodology for calculating marginal customer costs, revenue allocation, and rate design.

C. The Settlement Agreement (Appendix A)

Sierra, ORA, and CSAA move to have approved a settlement agreement to settle all issues in this proceeding pertaining to Sierra's revenue requirement. The settlement agreement proposes that the increase to Sierra's revenue requirement should be increased $3.02 million (or 5.8%). The settlement agreement includes a comparison exhibit that shows the forecasted results of operations for the twelve months ended December 31, 2003. It shows a summary of the results of operations change by unbundled component; it details the results of operations by unbundled component after the stipulated revenue requirement; and it details the results of operations by unbundled component before the stipulated revenue requirement. The proposed settlement does not resolve the revenue allocation and rate design issues applicable to the increase in Sierra's revenue requirement.

1. The Settlement Agreement is supported by the Record

In phase 2, the initial revenue requirement increase request for Sierra and ORA was $4.767 million and $1.604 million, respectively. Both Sierra and ORA agreed to several adjustments and by the end of the hearings, the adjusted revenue requirement increase request for Sierra and ORA was $3.871 million and $2.662 million, respectively. Settlement discussions were held following the hearings and ORA agreed to accept Sierra's water division reallocation adjustment in the amount of $.358 million. In turn Sierra accepted ORA's remaining adjustments related to: Merger cost amortization - $.191 million; Customer Service and Information Expenses - $.190 million; Administrative and General Expenses - $.176 million; and Transmission Plant Additions - $.294 million. The result of those adjustments is the settlement revenue requirement proposed increase of $3.020 million.

Sierra has agreed to accept ORA's adjustment of $.191 million pertaining to costs associated with its merger with Nevada Power Company. Sierra and ORA agree that Sierra's acceptance of this adjustment is strictly for settlement purposes and does not constitute a waiver of Sierra's right to seek recovery of merger costs in a proceeding before the Public Utilities Commission of Nevada. ORA agrees that Sierra may recover its costs for the implementation of its new billing system in the amount of $2,420,000 amortized over 5 years and that ECAC should be reinstated either as a result of adoption of Resolution E-3817 or as a result of the final decision in this proceeding.

The record contains all the information necessary for the Commission to find the settlement agreement reasonable. We have before us the prepared testimony of the parties, the additional testimony of the hearing, the exhibits, and the tables attached to the settlement agreement. The revenue, expenses, and rate base agreed to by the parties in the settlement agreement are consistent with the evidence and Commission decisions.

2. The Settlement Agreement is Consistent with Law

The terms of the settlement agreement comply with all statutes and prior Commission decisions.

3. The Settlement Agreement is in the Public Interest

The settlement agreement is a reasonable compromise of the parties' respective positions. It resolves contentious issues raised by ORA representing residential and small business ratepayers, and by CSAA representing large electric users. It provides a rate of return of 9.04%, which is well within the parameters of electric utility service (Pacific Gas and Electric Company (PG&E) - 9.24%: SCE-9.75%) and conforms to D.02-11-027 where Sierra Pacific's rate of return was set at 9.04%.

D. Marginal Customer Costs

ORA accepts Sierra's calculation of marginal *energy* and *demand* costs. However, ORA and Sierra differ over the appropriate treatment of marginal *customer* costs. With respect to marginal *customer* costs, ORA recommends the Commission continue to rely on its preferred New Customer Only (NCO) methodology to allocate marginal customer costs. Sierra recommends using the Real Economic Carrying Costs (RECC) approach to measuring marginal customer costs. Sierra's methodology allocates a greater share of costs to residential classes (56.5 %) than would occur under the NCO method (53.3 %).[1]

Under the RECC approach, the annual customer investment costs- - the transformer, service drop, and meter (TSM)- - are multiplied by an annual economic carrying cost. This yields annual customer related investment costs. Variable costs such as billing, metering, and customer services are then added to the annual investment costs.

Under the NCO method the full lump sum costs of new hook-ups are allocated to each class based on the number of new customers. Specifically, the NCO methodology replaces the RECC factor with a replacement or present value factor. The NCO approach also includes adjustments for billing, metering, and related customer services. Finally, the NCO methodology allocates marginal customer costs to each class based on the number of new hook-ups in each class.

Sierra strongly opposes the use of the NCO method to determine customer cost responsibility. It says that the NCO method is based on the company's expected investment in new and replacement customer hookups each year, which is derived from estimates of new customer growth plus failures of existing hookups. The total annual investment is then allocated among all customers, existing and new, to derive a cost per customer. Sierra believes it is not a cost in any meaningful context of a marginal cost. It argues that the NCO method

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[1] CSAA does not appear to take any position on the marginal cost methodologies proposed by either ORA or Sierra for calculating the customer class cost. The majority of CSAA's arguments focus on its proposal for setting rates at marginal cost without any reference as to which marginal costs result should be applicable to its large commercial customers served from Schedule A-3.

spreads the expected investment among all customers, new and existing. Efficient pricing dictates that the customer should be exposed to the full cost of his decision to connect to the system. The NCO method does not achieve this when it spreads the investment among all customers. The new customer sees only a fraction of the hookup costs he incurs. Furthermore, it says, the NCO method also includes replacement costs each year, which are not marginal with respect to the addition of a new customer. They would occur whether or not a new customer is connected to the system. Inclusion of these costs in the marginal cost study is not appropriate.

Sierra contends that the NCO methodology breaks down when customer growth is negative. ORA recognizes this limitation of the NCO methodology, but submits that it is not relevant in the present case. ORA has shown, and Sierra does not dispute, that the company's growth factor is not negative. For the 2003 test year, Sierra's estimated customer growth is 1.1%, and was even higher at 1.7% between 2001 and 2002. Sierra's customer growth rates were similar to those experiences by Southern California Edison Company (SCE) and Pacific Gas and Electric Company (PG&E).

Both ORA and Sierra cite economic theory to support their contrary arguments. In this battle of theories played out over the years, we have come down on the side of the NCO analysis. We are not persuaded to change.

In D.96-04-050, we endorsed the NCO method, stating that:

> We believe that marginal cost principles dictate that a class with more new hookups, relative to others, should have responsibility for a larger portion of associated marginal costs, just as a class with more coincident peak demand should be assigned a higher proportion of marginal generation costs. The rental method does not reflect this fundamental reality. . . . Second, we find that the

> rental method is premised on an assumption concerning opportunity value that does not hold for customer hookups.
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> Third, we believe that the rental method does not produce a competitive price for customer hookups, and, in fact, significantly overstates the price that would prevail in a competitive market. . . .[2]

In D.97-04-082, we elaborated on our support for the NCO method:

> The NCO method is preferable to the rental method as it improves both the price signal to the customer and costing accuracy. Parties have not presented any new evidence in this proceeding that causes us to change the conclusion we reached in PG&E's last BCAP, D.95-12-053 or Edison's GRC, D.96-04-050.[3]

Sierra's objection to the NCO method on the ground that it would produce inappropriate costs if the growth of customers were extremely low or negative, is not applicable here. For test year 2003, Sierra is forecasting a customer growth rate of 1.1 %. Over the period December 2001 to December 2002, Sierra experienced a customer growth rate of 1.70 % in its California service area. Sierra's customer growth rates are similar to those experienced by SCE and PG&E.

E. Revenue Allocation

1. ORA

ORA recommends a different methodology than that used by Sierra and CSAA for determining the revenue allocation to the various customer classes. ORA recommends that marginal customer costs be based on the NCO

[2] D.96-04-050, 65 CPUC2d 362, 404.

[3] D.97-04-082, *mimeo.*, at 144; 72 CPUC2d 151, 193.

methodology, which we adopt. ORA does not object to Sierra's calculation of marginal energy and demand marginal costs. The parties have reached a settlement on the overall California jurisdiction revenue requirement increase for test year 2003 of $3,020,000, representing a 6.2 % increase to Sierra's California customers. Thus, the total California jurisdiction revenue requirement at proposed rates to be allocated to the various customer classes is $51,015,000. The proposed allocation absorbs the 2¢/kWh interim increase.

To minimize rate shock to California ratepayers, rather than strictly applying marginal costs revenue responsibility to the various customer classes, ORA recommends an increase over present rate revenues of 8.8% for all customer classes, except for rate schedules A-2 (Medium General Service) and A-3 (Large General Service). For the A-2 and A-3 customer classes, ORA recommends a zero rate increase. (*See* Table 1.) ORA agrees that because the A-2 and A-3 class marginal costs are significantly below their current revenue allocation it would be inequitable to raise their rates.

TABLE 1

ORA Recommended Revenue Allocation
Test Year 2003 ($000s)

Customer Class	Annual Revenue Present Rates	ORA Proposed Revenue Allocation	Percent Increase Over Present Revenues
Residential (DM-1, D-1)	$23,444	$25,506	8.8%
S/M Residential (DS-1)	381	414	8.8%
A-1	9,860	10,727	8.8%
A-2	5,348	5,348	0.0%
A-3	8,711	8,711	0.0%
Street Lights	92	100	8.8%
OLS	152	166	8.8%
PA	40	43	8.8%
Total Revenue	$48,028	$51,015	6.2%

2. Sierra

Sierra proposes a revenue allocation methodology that would apply an average system rate to all classes capping increases to each class at 5%. Two commercial classes, A-2 and A-3, would see their contribution to revenue requirement reduced slightly, but not nearly as much as if true cost-based rates were adopted. In Sierra's view, its revenue allocation methodology represents a middle ground between ORA's proposal to keep A-2 and A-3 rates at current levels while spreading the increase in revenue requirements to all remaining classes on an equal percentage basis and CSAA's proposal to immediately move to cost-based rates for all classes.

Under Sierra's proposed cost methodology, the A-2 (medium commercial) and A-3 (large commercial) customers have cost-based revenue requirements that are under their present rate revenues by 18.6% and 15.9%, respectively. Sierra calculates that this provides an annual subsidy of nearly $2.4 million to other classes by the A-2 and A-3 classes. Sierra has calculated that ORA's marginal cost proposal provides a comparable subsidy slightly above $2.0 million under present rates. This results, in Sierra's opinion, that 14.5% (using ORA's analysis) to 16.9% (using Sierra's analysis) of the A-2 and A-3 customers' collective revenue requirement presently covers costs that are the direct responsibility of other classes.

Sierra's comparison is shown in Table 2.

TABLE 2

RATE IMPACTS BY CLASS BASED UPON THE STIPULATED REVENUE REQUIREMENT OF $51,025 MILLION[4]

Increase/Decrease in Class Revenue Requirement Under Sierra's, ORA's & CSAA's Revenue Allocation Proposals[5]

Case 1: Using RECC Marginal Cost Study Results; Case 2: Using NCO Marginal Cost Study Results

Case 1: Revenue Allocation Results Using Marginal Customer Costs Based on the Real Economic Carrying Charge Method (RECC)

Class	(a) Equal Percent of Marginal Cost Under Both Sierra's ORA's Rate Design	(b) Sierra's Primary Proposal Using the 5% Cap Method	(c) Sierra's Alternate Proposal Using the 5% Cap & Floor Method	(d) ORA's Proposal	(e) CSAA's Primary Proposal
Res. (DM-1, D-1)	19.52%	11.24%	10.89%	8.82%	19.52%
Sub-meter Res. (DS-1)	82.76%	11.24%	10.89%	8.82%	82.76%
A-1	7.63%	11.24%	10.89%	8.82%	7.63%
A-2	-21.08%	-7.74%	-5.00%	0.00%	-21.08%
A-3	-18.44%	-4.67%	-4.97%	0.00%	-18.44%
Street Lights	16.34%	11.24%	10.89%	8.82%	16.34%
OLS	38.02%	11.24%	10.89%	8.82%	38.02%
PA	40.34%	13.19%	12.83%	8.82%	40.34%

[4] The results presented herein incorporate the Stipulation on the revenue requirement in this case. The total stipulated revenue requirement is $51,284. However, for rate design purposes this amount is reduced by public purpose program revenues (PPP) of $259,000. The PPP revenues are deducted from the unbundled distribution revenue requirement.

[5] The rate impacts for ORA and CSAA reflect their respective proposals regarding revenue allocation in this proceeding. The differing rate impacts by class result from the different revenue allocation methodologies proposed by each of the parties.

TABLE 2 (*con't.)*

RATE IMPACTS BY CLASS BASED UPON THE STIPULATED REVENUE REQUIREMENT OF $51,025 MILLION

Increase/Decrease in Class Revenue Requirement Under Sierra's, ORA's & CSAA's Revenue Allocation Proposals

Case 1: Using RECC Marginal Cost Study Results; Case 2: Using NCO Marginal Cost Study Results

Case 2: Revenue Allocation Results Using Marginal Customer Costs Based on the New Customer Only (NCO)

Class	(f) Equal Percent of Marginal Cost Under Both Sierra's and ORA's Rate Design	(g) Sierra's Primary Proposal Using the 5% Cap Method	(h) Sierra's Alternate Proposal Using the 5% Cap & Floor Method	(i) ORA's Proposal	(j) CSAA's Primary Proposal
Res. (DM-1, D-1)	16.51%	11.24%	10.54%	8.82%	16.51%
Sub-meter Res. (DS-1)	112.52%	11.24%	10.54%	8.82%	112.52%
A-1	4.38%	11.24%	10.54%	8.82%	4.39%
A-2	-17.26%	-10.44%	-5.00%	0.00%	-17.26%
A-3	-10.41%	-3.02%	-3.63%	0.00%	-10.41%
Street Lights	21.27%	11.24%	10.54%	8.82%	21.27%
OLS	39.69%	11.24%	10.54%	8.82%	39.69%
PA	41.08%	15.22%	14.52%	8.82%	41.08%

3. CSAA

CSAA is an alliance of the major ski resorts in the Lake Tahoe area which purchase power from Sierra. Its members, Alpine Meadows Ski Resort, Heavenly Ski Resort, Trimont and Land Company dba Northern at Tahoe, and Squaw Valley Ski Corporation, all purchase power under Sierra Pacific's A-3 rate schedule. The A-3 class also includes school districts, utility districts, hotels, and grocery stores. CSAA submits that the Commission should not approve the cost allocation or rate design proposed by either Sierra or ORA and should require Sierra to establish rates on marginal cost. CSAA argues that neither Sierra nor ORA have produced any tangible evidence of the existence or extent of customer economic hardship that might result from the implementation of marginal cost based rates; neither Sierra nor ORA have considered whether existing or potential non-rate making mitigation solutions will sufficiently alleviate customer economic hardship that might result from the implementation of marginal cost based rates; and that the cost allocation and rate design proposals by both Sierra and ORA represent a movement away from marginal cost based rates.

CSAA agrees with Sierra's initial method of developing the true revenue responsibility of each class through the equal percentage marginal cost (EPMC) method, which aligns revenue responsibility closely with each customer class' cost causing behavior. However, CSAA points out, Sierra then applies a 5% capping mechanism that shifts revenue responsibility to the A-1, A-2, and A-3 customer classes such that the resulting rates for these classes are artificially high, while the rates for others are too low. While Sierra's marginal cost allocation shows that the true A-3 customer class share of revenue requirement is 13.89%, the proposed revenue requirement for A-3 is 16.35%, a 17.7% increase over its true allocated revenue requirement. CSAA describes this result as a "penalty" above the true costs allocated to A-1, A-2, and A-3 customers. The A-class customer absorbs the other customer class' deficiency in the amounts of $345,000 (A-1), $771,000 (A-2), and $1,297,000 (A-3) annually. For the 36 A-3 customers, including financially strapped school and utility districts, this penalty is $36,000 per customer per year.

CSAA says that ORA completely ignores the marginal cost study and the EPMC based allocation of customer class revenue responsibility except to identify those customer classes for whom the study calculates a revenue responsibility below that which results from current rates. Once identified, ORA arbitrarily fixes customer classes A-2 and A-3 at current rates (which include the interim increase authorized by Decision (D.) 02-07-031) then allocates the remaining revenue requirement across the other customer classes so that those classes receive the same increase over current rates. This results in a penalty to the A-2 and A-3 class to absorb other class' deficiency of $993,000 (A-2) and $1,042,000 (A-3) annually. For the 36 A-3 customers this penalty is $28,944 per customer per year.

CSAA asserts that ORA, and to a lesser degree Sierra, mistakenly measures the impact of marginal cost based customer class revenue responsibility by comparing it with customer class revenue based on the rates after the interim increase granted in Phase 1 of this case rather than based on the last rates found to be just and reasonable prior to the interim increase. CSAA says this is an inappropriate means of comparison which gives an inaccurate impression about the combined phase 1 and phase 2 rate impacts upon these classes. CSAA believes that the interim across the board increase of 2¢/kWh was not intended to distort or prejudge the proper revenue allocation among classes.

4. Discussion

We will adopt ORA's rate allocation. Table 2, Case 2, Column (f) (supra) sets forth the rate increase to each customer class if marginal cost pricing were implemented. Column (f) represents Sierra's estimate of the revenue requirement percentage increase to each customer class if all customer classes were allocated their share of the total revenue requirement using marginal cost principles. The revenue requirement basis for column (f) is $51,025,000, which includes the 2¢/kWh surcharge authorized in D.02-07-031. Residential rates would increase over 16.5% while A-2 rates would decrease 17.3% and A-3 rates would decrease 10.4%. Because A-2 and A-3 customer rates are currently substantially above marginal costs ORA recommends neither an increase nor a decrease. We agree.

CSAA proposes a 10.4% decrease of A-3 and 17.3% from A-2, based on strict marginal cost principles, while ignoring the mitigating circumstances which this Commission has always considered when allocating rate increases. In this instance Sierra's residential customers have seen a 27.7% rate increase in July 2002, and, to be responsible for their share of the $3.02 million rate increase under ORA's proposal, will pay an additional 8.8%. An almost 40% increase in little more than a year is substantial and a hardship. The A-2 and A-3 customers pay no part of the $3.02 million rate increase. Under the circumstances of this proceeding, when allocating an overall system increase, it would be imprudent to increase rates substantially for one class of customers while substantially decreasing rates for others.

CSAA argues that ORA distorts the impact of ORA's proposal by using the Phase 1 interim rates (2¢/kWh across the board) as a base to characterize the impact on schedules A-2 and A-3 customer classes as rate decreases, rather than using the pre-interim increase as a base. We believe it is inappropriate to compare the present rate revenues excluding the interim increase to determine whether the 2003 test year proposed revenue requirement would result in an increase or decrease to the various customer classes. The measure of the rate impacts of the revenue requirement on the various customer classes should be based on present rate revenues which include the interim rate increase.

F. Rate Design

1. Customer Charges

Sierra proposes to double its customer charges for its commercial classes. Sierra argues that its customer charge should be set at cost-based levels to recover facilities cost that do not vary with usage. ORA recommends a lesser increase of 25%.

	Present Rates	Sierra Proposed	ORA Proposed
A-1	7.20	15.00	9.00
A-2	80.00	160.00	100.00
A-3	350.00	700.00	437.50

Consistent with its approach to its rate design, ORA recommends a more gradual increase towards a cost-based monthly customer charge. ORA agrees that the customer charge should reflect the non-usage based facility costs, but it argues that moving towards this goal should be approached on a gradual basis. Accordingly, ORA recommends increasing the commercial monthly customer charge by no more than 25% for all commercial tariff schedules. Sierra's request for doubling the customer charge for these customer classes is excessive. ORA's recommendation to increasing the commercial monthly customer charge by no more than 25% for all commercial tariff schedules is reasonable.

2. Tier 1 and Tier 2 Residential Rate Differential

Sierra uses a 15% tier differential in developing the energy rate for its residential tariffs. The tier differential is calculated excluding any customer charge, thus is called the "simple basis" approach. Sierra proposes to set the residential baseline and excess rates on a simple basis by using only the tier 1 and tier 2 energy revenues. The difference between the excess rate over the baseline rate is the tier differential. In making this computation, Sierra excludes all customer charge revenues from the calculation; only energy revenues are used to establish the relative rates.

ORA recommends a modified composite methodology for determining the tier 1 and tier 2 residential rates differential. Under ORA's methodology a 1.15:1 composite tier differential results between the baseline rate (tier 1) and the excess rate (tier 2). ORA did not apply Sierra's methodology for determining the tier differential because it does not comply with Pub. Util. Code § 739(3), which states that:

> "At least until December 31, 2003, the Commission shall require that all charges for residential electric customers are volumetric. . . "

ORA argues that the Sierra residential customer charge has to be treated as volumetric for the purpose of calculating the tier differential. Commission decisions support the use of the composite tier methodology. Based on ORA's analysis of Sierra's inverted rate structure, Sierra's composite baseline rate (including customer charge revenues) is higher than its proposed tier 2 energy rate, thus not in compliance with an inverted rate structure.

We adopt ORA's method of setting the tier differential. This method has been used consistently in the past and recently in D.00-04-060, where we again found it appropriate to use the composite method in determining the tier 1 and tier 2 differential. We said:

> Section 739 (c) requires the Commission to establish "baseline rates" which apply to the lowest block of an increasing block rate structure. The statute is premised on the principle that "electricity and gas are necessities, for which a low affordable rate is desirable." (739 (c)(2).) Section 739.7 similarly requires an "appropriate inverted rate structure." These code sections have been consistently interpreted to include the customer charge in determining whether the rate structure is, in fact, inverted. Under this "composite tier differential" approach, customer charges are considered part of the Tier I, or baseline, rate for the purpose of calculating tier differentials.
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> We reject SoCalGas' proposal. As we said in the last SoCalGas BCAP, "Therefore we should retain the existing tier differential calculated on a composite basis. The composite tier differential is more meaningful than the simple differential because it gives the price for access and purchase of a quantity of gas that covers basic needs. (D.97-04-082, *mimeo.*, *et* 118.) (D.00-04-060, *mimeo.*, at 105, 107; 202 PUR 4th 255, 310,311.)

3. Areas Accepted by ORA

Sierra's baseline allowances are consistent with the final Phase 1 Interim Order in R.01-05-047 (the Baseline Order), which sets the new baseline allowances for residential customers in tier 1. ORA accepts Sierra's proposed new baseline allowances.

Sierra's California Alternative Rates for Energy (CARE) discount rate of 20% is consistent with D.02-01-040. Accordingly, ORA accepts Sierra's proposed CARE billing determinants. ORA's base energy rate component is discounted by 20% to determine the residential CARE energy rates.

Finally, ORA agrees with Sierra's request to merge tariff schedule A-1A with A-1. Tariff schedule A-1A was established for small commercial customers whose demand was greater than 20 kW, and which did not qualify for the AB 1890 mandated 10% discount. Customers with demand less than 20 kW were served out of schedule A-1, which provided a 10% discount from the frozen base rate. ORA agrees that with expiration of the AB 1890 rate freeze period, there is no longer a need for the separate rate schedules.

G. Compliance with Rate Reduction Statutes Pre and Post Deregulation/Restructuring

AB 1890 (Brulte 1996) legislated rate reduction for residential and small commercial customers through the inclusion of Pub. Util. Code § 368(a), which provided that rates for residential and small commercial customers were to be reduced to a level at least ten percent below the rates in effect on June 10, 1996. Subsequently, the legislature passed § 368.5 which prevented the CPUC from eliminating the AB 1890 promised 10% rate reduction on residential and small commercial customers because of the passage of time or the end of the AB 1890 transition period.[6] Because § 368.5's safeguarding of the 10% rate reduction prevails over AB 1890's schematic for the legislated rate reduction,[7] the CPUC must now undertake a thorough review of the revenue requirements and rate design of any electric utility before it can raise the rates of residential and small commercial customers.

In D.02-07-031, we granted Sierra Pacific an interim rate increase based on our determination that is was needed in order to provide Sierra Pacific with a

[6] *See* Pub. Util. Code § 368.5 (a).

[7] *See* § 368.5(a).

reasonable opportunity to earn a forecast rate of return of 4.0%, which we determined not to be excessive. The proceeding before us now is a general rate case in which the commission is to look comprehensively at all the costs and revenue requirements of the company and to true up the issues remaining from our interim decision in D.02-07-031. In this decision, the parties entered into an uncontested settlement of Sierra Pacific's revenue requirement, expenses, and rate base. This proceeding constitutes the kind of thorough review of the revenue requirement and rate design of an electric utility contemplated by SB 85xx. Although the proposed decision in this proceeding resulted from a settlement rather than a litigated analysis, the proceeding and the settlement suffices for SB 85xx purposes as within the Commission's authority to institute a proceeding "to raise rates for reasons other than the termination of the 10-percent rate reduction set forth in subdivision (a) of Section 368."[8] The analysis contained below discusses the reasons for the revenue requirement and the resulting rate increases for all Sierra Pacific customers, including the residential and small commercial customers, adopted herein.

H. Energy Cost Adjustment Clause (ECAC)

On January 8, 2003, Sierra filed AL 294-E requesting authority to reinstitute its ECAC mechanism. On June 10, 2003, the Energy Division submitted draft Resolution E-3836 to the Commission. That resolution proposed that Sierra's advice letter and supplemental advice letter should be denied without prejudice on the ground that the reinstitution of ECAC should be addressed as part of the

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[8] Section 368.5(b).

Commission's final decision in Phase 2 of A.01-06-041 and not by advice letter. On July 10, 2003, the resolution was approved.

On June 6, 2003, Sierra, ORA and CSAA submitted a joint motion for approval of a partial Phase 2 Settlement Agreement pertaining to all issues on Sierra's revenue requirements. Section 5 of the Settlement Agreement provides that Sierra's ECAC mechanism may be reinstituted. As we approve the settlement, we approve reinstituting the ECAC. The implementation of the ECAC will not change any rates authorized by this decision.

I. Comments on Proposed Decision

The proposed decision of the Administrative Law Judge was mailed to the parties in accordance with Pub. Util. Code § 311(d) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed only by Sierra, which referred to its marginal cost arguments discussed above. No changes to the decision are made.

J. Assignment of Proceeding

Loretta Lynch is the Assigned Commissioner and Robert Barnett is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. The preferred method for estimating marginal customer cost is the New Customer Only method.

2. ORA's revenue allocation methodology in which the increase to Sierra's revenue requirement is allocated equally to all customer classes except for rate schedules A-2 and A-3 is fair and reasonable to all customer classes. Table 1 is adopted.

3. ORA's recommendation for the A-2 and A-3 schedules of a zero rate increase and capping present rate revenues for these customer classes is a

reasonable compromise between cost-based rates and mitigation of rate impacts to residential customers.

4. ORA's composite based calculation for determining the tier 1 and tier 2 residential rate differential is consistent with past Commission decisions and Pub. Util. Code § 739. It is adopted.

5. The increase customer charge to Sierra's commercial class customers should be A-1, $9; A-2, $100; A-3, $437.50. They are adopted.

6. There is no evidence that demonstrates that the ski areas will be harmed under ORA's revenue allocation proposal.

7. It is not appropriate to exclude the interim rate increase when determining the reasonableness of increasing or decreasing rates to customer classes.

8. The settlement agreement filed June 6, 2003 is supported by the record and is reasonable. It is adopted.

9. Sierra's proposed baseline allowances are reasonable and adopted.

10. Sierra's proposed CARE discount rate and billing determinants are reasonable and adopted.

11. Sierra shall merge Schedule A-1A with A-1.

12. Sierra may eliminate the 10% credit for residential and small commercial customers.

13. Sierra may reinstitute an ECAC.

Conclusions of Law

1. The adjustments to base rates in this proceeding are appropriate to maintain Sierra's ability to provides adequate service.

2. The settlement agreement is reasonable in light of the whole record, consistent with law, and in the public interest.

3. The rates and charges authorized by this decision are reasonable.

4. This proceeding and the settlement suffices for SB 85 xx purposes as within the Commission's authority to institute a proceeding "to raise rates for reasons other than the termination of the 10-percent rate reduction set forth in subdivision (a) of Section 368."

ORDER

IT IS ORDERED that:

1. The settlement agreement is approved.

2. Within 10 days after the effective date of this order Sierra Pacific Power Company shall file an Advice Letter with revised tariff sheets to implement the authority granted in this decision. The revised tariff sheets shall become effective on the date filed subject to the Energy Division determining that it is in compliance with this decision. The revised tariff sheets shall apply to service rendered on or after their effective date.

3. This proceeding is closed.

This order is effective today.

Dated January 8, 2004, at San Francisco, California.

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

APPENDIX A

D0401027 APPENDIX A TO A0106041